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No. 64613-3-I

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON

In re the Matter of the:

ESTATE OF BARBARA J. NELSON,

WILLIAM C. NELSON, BRIAN S. NELSON and JANET MCCANN,
Personal Representatives of the Estate of Barbara J. Nelson,

Appellants,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE

Respondent.

BRIEF OF APPELLANTS

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I. INTRODUCTION

In this case, the Washington State Department of Revenue ("DOR") has imposed an unlawful tax on property that was not owned or transferred by the Estate of Barbara J. Nelson ("Barbara's Estate"). The property belonged instead to trusts created under and owned by Barbara's deceased spouse, William C. Nelson. In 2004, William's estate ("William's Estate") transferred property into two trusts created under his Will, which would pass to beneficiaries designated by William's Will ("William's Trusts" or "Trusts"). Although William's Trusts distributed income to Barbara during her lifetime, it is undisputed that Barbara's interest terminated at her death, and her Estate did not own or transfer property in the Trusts at Barbara's death.

In 2005, the Washington Supreme Court phased out the state's former "pickup tax" scheme in *Estate of Hemphill v. Dep't of Revenue*, 153 Wn.2d 544, 547, 105 P.3d 391 (2005). Under *Hemphill*, Barbara's Estate would have paid no estate tax at her death. Although the Washington legislature passed a new stand alone tax on May 17, 2005, the statute provides that it must be applied prospectively to transfers of a decedent's property. The DOR's own regulations also excluded William's Trusts from the new estate tax. Nevertheless, the DOR seeks to retroactively impose a tax on William's Trusts by taxing Barbara's Estate.

Under the language of the new Act, the uniform rule of law in Washington, the U.S. Supreme Court and the only other state to address a similar issue, Barbara's estate cannot be required to pay an estate tax on William's Trusts because she did not own or transfer property in the trusts. The DOR's interpretation of the new Act would also lead to an unconstitutional retroactive tax. The Appellants ask this Court to apply the plain language of RCW 83.100.040 and the Regulations promulgated under WAC 458-57 and reverse the trial court's decision. The Appellants ask this Court to enter summary judgment in their favor.

II. ASSIGNMENTS OF ERROR

A. Assignments of Error.

The trial court erred when it granted the DOR's motion for summary judgment and denied the Estate of Nelson's motion for summary judgment on the Estate's objections to the DOR's findings that additional estate tax was due.

B. Issues Pertaining to Assignments of Error.

1. Can the DOR impose and collect an estate tax on an irrevocable trust created by a predeceasing spouse, when both Washington Estate and Transfer Tax Act, longstanding Washington precedent and the uniform rule in other jurisdictions requires a transfers of property owned by the decedent?

2. Can the DOR circumvent the Supreme Court's ruling in *Hemphill* by imposing an estate tax on the William C. Nelson's transfer to an irrevocable trust?

3. Does the DOR's attempt to tax property held in an irrevocable trust created before the enactment of Washington's new stand-alone estate tax violate the United States and Washington Constitutions?

4. Does the DOR's attempt to tax property held in an irrevocable trust created before the enactment of Washington's new stand-alone estate tax violate the DOR's own regulations as adopted in 2006?

III. STATEMENT OF THE CASE

A. William C. Nelson's Estate.

Although this is an appeal involving the estate of decedent Barbara J. Nelson ("Barbara") under the current Estate and Transfer Tax Act, the tax imposed by the DOR relates to a transfer by Barbara's predeceasing husband William C. Nelson ("William") under a prior tax scheme. Thus, the background of William's Estate and the change in Washington's tax regime is important to the understanding of the issues on this appeal.

1. Washington's Prior Estate Tax was Substantially Phased Out as of William's Death.

William died on September 14, 2004. CP 208. As of the date of William's death, Washington's estate tax had been almost completely phased out. *See Estate of Hemphill*, 153 Wn.2d 544, 547, 105 P.3d 391

(2005). The Court in *Hemphill* held that Washington's estate tax had been phased out during a period beginning in 2001 and ending on December 31, 2004. *Hemphill*, 153 Wn.2d at 551. When William died, the Washington estate and transfer tax was a "pickup tax" scheme[1], a mechanism for sharing estate tax revenues between the federal government and the state government. *See Hemphill*, 153 Wn.2d at 547. Washington's estate tax "picked up" the exact amount of state death tax credit under federal law. The pickup tax did not increase the total amount of estate taxes paid by an estate since the amount of estate tax paid to the state was credited against the allowable federal estate tax. *Hemphill,* 153 Wn.2d at 547-48. The pickup tax was therefore completely dependent upon the federal death tax credit.

Beginning in 2001, Congress phased out the state death tax credit under the Economic Growth and Tax Relief Reconciliation Act ("EGTRRA"), eliminating it completely for estates of persons dying after December 31, 2004. Economic Growth and Tax Relief Reconciliation Act, P.L. 107-16, § 531. Because Washington's pickup tax was matched with the federal tax scheme, EGTRRA also effectively phased out Washington's estate tax. *Hemphill,* 153 Wn.2d at 548-49.

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[1] The pickup tax was enacted in 1981 by Initiative 402. In 1981, the voters abolished Washington's previous inheritance tax and created a state estate tax based exclusively on the credit allowed on a decedent's federal estate tax return for estate taxes paid to a state. Laws of 1981, 2nd Ex. Sess., Ch. 7 (Initiative No. 402, approved Nov. 3, 1981).

Despite EGTRRA's phase out, the DOR continued to impose a full estate tax based upon an argument that the language of the Washington statute specifically froze the state death tax credit as of 2001. *Hemphill*, 153 Wn.2d at 549-52. This state's supreme court disagreed, and ruled that the DOR was only entitled to impose a tax on the reduced federal credit each year after 2001: "[F]or decedents dying in 2002, a 75 percent credit was allowed; in 2003, a 50 percent credit; and in 2004, a 25 percent credit." *Id.* at 548-49.

When William died, the Washington estate tax imposed by the DOR had been 75% eliminated. Under *Hemphill*, William's estate was only subject to 25% of the estate tax the DOR would otherwise impose. Less than three months after William's death, Washington's estate tax was completely phased out. The Washington estate tax was effectively repealed.

2. William Nelson's Trusts.

William's Last Will and Testament directed the transfer of certain property in William's Estate ("William's Estate") to two trusts, effective as of his date of death ("William's Trusts"). *See* CP 212-35[2]. William's Last Will and Testament also directed the ultimate disposition of the assets in William's Trusts. *Id.* Under the Will, Barbara would receive income

[2] William's Trusts are created and directed pursuant to Paragraph Sixth of William's Will. *See* CP 214-15.

from the Trusts during her lifetime. *See* CP 214-15. Upon Barbara's death, the entirety of William's Trusts passed to other beneficiaries identified by William's Will. *Id.* Barbara would retain no interest in William's Trusts. *Id.*

On its federal estate tax return, William's Estate also made an irrevocable election under I.R.C. § 2056(b)(7) to treat the Trusts under federal tax law as "QTIP Trusts[3]." When a QTIP election is made, trust property will qualify for the marital deduction on the federal return. I.R.C. § 2056(b)(7)(B)(v). By qualifying a QTIP trust for the marital deduction, no tax is paid on the trust assets at the time of the first spouse's death. I.R.C. § 2056(a). However, because those assets would have been taxed at the first death but for the deduction, any assets remaining in the QTIP trust on the surviving spouse's death ("QTIP property") are subject to the federal estate tax at that time. I.R.C. § 2044(b)(1)(A).

No similar Washington QTIP election was available at that time.

3. William Nelson's Estate is Closed.

William's Estate properly filed a Washington State Estate and Transfer Tax Return (for Deaths Occurring Before May 16, 2005). CP 208. William's Estate is a separate probate matter, and the DOR is not

[3] For a comprehensive discussion of QTIP trusts and the associated provisions of the Internal Revenue Code, *see* JOHN R. PRICE AND SAMUEL A. DONALDSON, PRICE ON CONTEMPORARY ESTATE PLANNING, § 5.23 (2009).

seeking any taxes from William's Estate in this proceeding. Neither did the DOR file any findings under RCW 83.100.150 that William's Estate owed any unpaid estate tax.

B. Legislature Enacts a New "Stand Alone" Estate Tax on May 17, 2005, After William's Death and the Creation of William's Trusts.

Shortly after William's death and the effective date of the transfer to William's Trusts, the Washington legislature enacted a new stand-alone estate tax to replace the eliminated pickup tax. On May 17, 2005, the Washington Legislature enacted a new stand-alone estate tax under the Washington Estate and Transfer Tax Act (the "Act"), Laws of 2005, Ch. 516 (codified in RCW Ch. 83.100). This new tax is not a pickup tax scheme, but rather a stand-alone estate tax based independent of federal taxes. In *Hemphill*, the supreme court held that "until or unless the legislature revises RCW 83.100.030 to specifically and expressly create a *stand alone* estate or inheritance tax," the state's estate tax would remain tied to the eliminated federal death tax credit. *Id.* at 551-52 (emphasis added).

Unlike the pickup tax, the new Washington estate tax is imposed "on every transfer of property located in Washington," regardless of the federal estate tax. *Id.* The tax is calculated based upon the "Washington taxable estate," which in turn is based on the taxable estate determined for

federal estate tax purposes ("federal taxable estate").

RCW 83.100.020(13) & (14).

The new Washington Estate and Transfer Tax Act also incorporates the unlimited marital deduction concept for state estate tax purposes. It allows for an irrevocable election to be made to qualify a QTIP trust for a state marital deduction. RCW 83.100.047. However, the election to qualify a QTIP trust for the state marital deduction is separate and distinct from an election to qualify the trust for the federal estate tax marital deduction. *Id.*

C. The 2006 Regulations Excluded Federal QTIP Property from the Washington Taxable Estate of the Second Spouse to Die.

On April 9, 2006, the DOR adopted regulations in connection with the new Act ("2006 Regulations"). CP 969-1014; *see* WAC Chapter 458-57.[4] Among other things, the 2006 Regulations set forth the manner in which the Washington taxable estate is to be calculated. WAC 458-57-105(2006); WAC 458-57-115 (2006). The 2006 Regulations make clear that the federal QTIP election and Washington state QTIP election are separate and distinct, noting that a personal representative may make a

[4] The DOR later amended two of its regulations effective February 22, 2009 ("2009 Amendments"). *See* WAC 458-57-105(3)(q)(vi) (2009); WAC 458-57-115(2)(d)(vi) (2009). The Barbara Nelson Estate filed its state estate tax return prior to the DOR's adoption of the 2009 Amendments. CP 109.

larger or smaller election for Washington estate tax purposes than for federal estate tax purposes. WAC 458-57-115 (2)(c)(iii)(A) (2006).

Under the Act and the 2006 Regulations, the calculation of the Washington taxable estate begins with the "federal taxable estate." RCW 83.100.020(13); WAC 458-57-105(3)(q) (2006).[5] The 2006 Regulations also direct that any federal QTIP property that was included in the federal taxable estate of the second spouse to die is to be excluded from the Washington taxable estate. WAC 458-57-105(3)(q)(vi) (2006); WAC 458-57-115(2)(d)(vi) (2006). The 2006 Regulations further provide that only the assets remaining in a Washington QTIP trust for which a Washington QTIP election was made are to be included in the surviving spouse's Washington taxable estate. WAC 458-57-105(3)(q)(v) (2006); WAC 458-57-115(2)(d)(v) (2006).

D. Barbara Died After the New Act and Her Estate Complied with the New Act and Regulations.

Barbara J. Nelson, a Washington resident, died on October 15, 2006, after the effective date of the new Act. Barbara's Estate owned and controlled property held by Barbara as of the date of her death. However, Barbara's Estate did not include the property in William's Trusts.

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[5] The federal taxable estate is defined as the taxable estate determined under Chapter 11 of the Internal Revenue Code without regard to the termination of the federal estate tax under EGTRRA or the deduction for state estate taxes under I.R.C. § 2058. RCW 83.100.020(14); WAC 458-47-105(3)(g); WAC 458-57-115(2)(e).

When Barbara's Estate filled out its *federal* estate tax return, it was required to make an adjustment and add back in the value of William's Trusts according to I.R.C. § 2044. However, as correctly required by the 2006 Regulations of the DOR, the assets of the William's Trusts were not included as a part of Barbara's Washington taxable estate. *See* WAC 458-57-105(3)(q)(vi); WAC 458-57-115(2)(d)(vi). Furthermore, because Washington's estate tax is only imposed "on transfers of property" of the deceased's estate, no tax could logically be imposed on Barbara's Estate for the transfer by William to William's Trusts. Barbara's Estate then paid Washington estate tax on all of the property that she owned and controlled at the time of her death.

The DOR issued a deficiency notice to Barbara's Estate stating, contrary to its own regulations, that the estate needed to include in her Washington taxable estate the property remaining in William's Trusts. Barbara's Estate declined to pay the amount cited in the deficiency notice and the DOR filed findings under RCW 83.100.150. Barbara's Estate timely filed objections to the DOR's findings. CP 8-19.

E. The Trial Court's Ruling.

The judicial proceeding in Barbara's Estate was consolidated with similar proceedings in the *Estate of Bracken* and the *Estate of Toland.* The consolidated estates then moved for motion for summary judgment to

preclude the DOR from imposing a tax on their respective marital trusts. CP 245-73, 191-240 & 274-497. The DOR filed a cross-motion for summary judgment. CP 44-188. The trial court granted the DOR's motion for summary judgment and denied the estates' motion. CP 1082-84. The trial court subsequently also denied the three estates' motion for reconsideration. CP 1094-96. Barbara Nelson's Estate now seeks review of the trial court's decision.

IV. ARGUMENT

A. The Applicable Standard of Review is *De Novo.*

The standard of review on this appeal is *de novo*. The Court reviews summary judgment rulings *de novo*. *York v. Wahkiakum Sch. Dist. No. 200*, 163 Wn.2d 297, 302, 178 P.3d 995 (2008); *Vallandigham v. Clover Park Sch. Dist. No. 400*, 154 Wn.2d 16, 26, 109 P.3d 805 (2005); *Castro v. Stanwood Sch. Dist. No. 401*, 151 Wn.2d 221, 224, 86 P.3d 1166 (2004). In reviewing a summary judgment ruling, the Court's inquiry is the same as the trial court. *Lybbert v. Grant County*, 141 Wn.2d 29, 34, 1 P.3d 1124 (2000).

In addition, the interpretation of a statute and its implementing regulations is a question of law, which the Court reviews *de novo*. *In re Impoundment of Chevrolet Truck*, 148 Wn.2d 145, 154, 60 P.3d 53 (2002). The Court reviews an agency's interpretation of statutes and the

application of the law *de novo* under the error of law standard, which allows the Court to substitute its own interpretation of the statute or regulation for the agency's interpretation. *Port of Seattle v. Pollution Control*, 151 Wn.2d 568, 593, 90 P.3d 659 (2004); *Postema v. Pollution Control Hearings Board*, 142 Wn.2d 68, 77, 11 P.3d 726 (2000); *St. Francis Extended Health Care v. DOR of Social & Health Services*, 115 Wn.2d 690, 695, 801 P.2d 212 (1990).

B. It is Undisputed That Barbara J. Nelson Did Not Own William's Trusts' Property, Which Vested in the Beneficiaries Upon Creation of the Trusts on September 14, 2004.

It is undisputed that William's Trusts are irrevocable trusts created by the personal representatives of William's Estate according to the terms of William's Will. CP 12 & 27. William's Trusts were valid trusts under Washington trust law when created as of his death on September 14, 2004[6]. *See In re Morton's Estate*, 188 Wash. 206, 61 P.2d 1309 (1946); 76 Am. Jur. 2d, Trusts, § 57 (2010); Uniform Trust Code § 402(a)(2). It is also undisputed that there was a transfer of property by William's Estate to the trusts as of William's death on September 14, 2004. *See* CP 12, 296. The distribution of trust property out of William's Trusts to beneficiaries of the Trusts is also controlled by William's Will. *See* CP 214-15.

[6] William's Trusts are both valid trusts under Washington trust law, and separately, "QTIP trusts" by virtue of an election made solely for purposes of federal tax law.

The DOR has conceded that when a marital trust is created by a first-dying spouse, the property in a marital trust is not property of the surviving spouse. CP 297. DOR Tax Policy Analyst Mark Bohe testified that marital trust property is not owned by the surviving spouse (in this case, the deceased, Barbara J. Nelson):

> Q: [T]he [marital] trust property is not the property of the second spouse?
> A: Yes, I would have to say that it is the property of the trust, not the second spouse.

Id. The interests of the beneficiaries of William's Trusts therefore vested at the time of the creation of the Trusts. *See Van Stewart v. Townsend*, 176 Wash. 311, 28 P.2d 999 (1934) (the fact that the beneficiaries were not to come into the enjoyment of the property until later, after the death of the donor does not affect the vesting of their interest). Barbara had a lifetime interest that terminated on her death. Neither Barbara nor her estate had any interest in the Trusts at her death.

C. A State Cannot Impose or Collect an Estate or Inheritance Tax Against Property Not Owned, Controlled or "Transferred" by the Decedent.

1. Under Longstanding Washington Precedent, a State Can Neither Impose nor Collect Estate Tax Against Property Unless There Has Been a Transfer of the Decedent's Property.

The new Act imposes a tax on *transfers*[7] *of property* by a decedent. RCW 83.100.040(1) (emphasis added). Under longstanding Washington precedent, a state cannot impose or collect an estate tax "**unless some right in it be transferred by the death of the decedent.**" *In re McGrath's Estate*, 191 Wn. 496, 503-05, 71 P.2d 395 (1937); *see also*, *Blodgett v. Silberman*, 277 U.S. 1, 48 S.Ct. 410, 413, 72 L.Ed. 749 (1928) (an inheritance or death tax is a tax not upon property but upon the right or privilege of succession to the property of a deceased person); *Coolidge v. Long*, 282 U.S. 582, 51 S. Ct. 206, 75 L. Ed. 562 (1931).

In *McGrath's Estate*, the State attempted to tax an interest in life insurance policies maturing on the decedent's passing. *Id.* McGrath

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[7] "Transfer" is defined in RCW 83.100.010(11) as meaning the same as " 'transfer' as used in section 2001 of the Internal Revenue Code." There is no further definition of "transfer" under IRC § 2001 in federal law. Although "transfer" has no special meaning in federal law, an estate tax can only be imposed on wealth *transfers*, not on wealth itself. *See* R. Stephens, G. Maxfield, S. Lind, D. Calfee & R. Smith, FEDERAL ESTATE AND GIFT TAXATION, at 2-2, ¶ 2.01 n.3 (8th ed. 2001). An indirect tax on the transmission of wealth is constitutional as long as it is imposed uniformly throughout the U.S. *Id.* In contrast, a direct tax on wealth must be apportioned across the states in accordance with their respective populations. *Id.*, citing Tribe, American Constitutional Law, at 841 (3rd ed. 2000). Thus, Washington's Estate and Transfer Tax Act may not tax Barbara's wealth, but may only tax transfers of Barbara's property.

Candy Company had purchased life insurance policies on McGrath's life, payable to the company on his death. When McGrath died, the State attempted to impose a tax on the basis of a new law, the Revenue Act of 1935, which provided that "insurance payable upon the death of a person shall be deemed to be part of the estate for purposes of computing estate tax." *Id.* at 497-98, 502.

The Washington Supreme Court analyzed for the first time the nature of an estate tax in Washington, and the authority of the state to collect such a tax. *Id.* at 502-03. The Court pointed out that the right of a sovereign to impose and collect a tax is derived solely from the act of a citizen in transferring property owned. *Id.* Estate taxes are not taxes in a strict sense, that is to say, they are not collected by virtue of the right of the sovereign to exact from its citizens from the corpus of their property for the support of the government. *Id.* They are taken out of property to which ownership has been suspended by the death of the taxpayer. *Id.* The sovereign is the "permissive intermediary through which the property of a decedent passes to his heirs or legatees," and the sovereign can take property out of this estate during this momentary legal custody. *Id.* What is retained, in exchange for permission to a decedent to pass title to his heirs or legatees, is an estate tax. *Id.* "It is therefore, in the very nature of things, impossible for an estate or inheritance tax to be exacted without

respect to something in which the decedent did not own or have some kind of right to at the time of his death, for in such a case there is no transfer." *McGrath's Estate*, at 503[8].

Because the decedent in McGrath did not own the property the state attempted to tax, no tax could be imposed. *Id.* at 503-04. The beneficiaries' right had previously vested. *Id.* The Court held that "the death of McGrath added nothing[9] to the company's right to the proceeds of the policies, for the right was from the beginning complete and indefeasible." *McGrath*, at 504.

> Here, the decedent never had any ownership or right of any kind in the policies in question or in the proceeds thereof. He had no vestige of control over them. He did not take them out. He did not pay the premiums.

McGrath, at 510. Thus, the court concluded, no tax could be imposed on the insurance proceeds or collected on the value of the insurance proceeds by virtue of McGrath's death, despite the language of the statute imposing a tax.

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[8] The *McGrath* court supported the principle that an estate tax cannot be collected with respect to property unless some right in it be transferred by the death of the decedent by a long line of U.S. Supreme Court precedent. *Lewellyn v. Frick*, 168 U.S. 238, 45 S.Ct. 487, 69 L.Ed. 934 (1925); *Helvering v. St. Louis Union Trust Co.*, 296 U.S. 39, 56 S.Ct. 74, 80 L.Ed. 29, 100 A.L.R. 1239 (1935); *Becker v. St. Louis Union Trust Co.*, 296 U.S. 48, 56 S.Ct. 78, 80 L.Ed. 35 (1935); *Bingham v. United States*, 296 U.S. 211, 56 S.Ct. 180, 80 L.Ed. 160 (1935).

[9] "As the trial judge somewhat whimsically, but very pertinently, remarked in his memorandum opinion, he furnished nothing except the death." *McGrath*, at 510.

2. The U.S. Supreme Court in *Coolidge v Long* Has Also Ruled That Trust Property Created by a Predeceasing Spouse is not Subject to Tax.

The United States Supreme Court has also held that an estate tax cannot be imposed upon an irrevocable trust created by a predeceasing spouse. *Coolidge v. Long*, 282 U.S. 582, 51 S. Ct. 206, 75 L. Ed. 562 (1931). At issue was a trust the Coolidges created in 1907 that gave each of them a life estate in the income of the trust. On the death of the survivor of Mr. and Mrs. Coolidge, the trust principal was to be distributed to the Coolidges' five sons. *Id.* at 593-94. Mrs. Coolidge died in 1921 and Mr. Coolidge died in 1925. *Id.*

In 1920, Massachusetts had enacted an excise tax on property that passed by deed, grant, or gift, which was made or intended to take effect in possession or enjoyment after the grantor's death. *Id.* at 594-95. The statute applied only to transfers occurring on or after May 4, 1920. *Id.* at 595. The issue was whether the taxable transfer occurred when the trust was formed in 1907 or at Mr. Coolidge's death in 1925 when the trust assets were distributed to the remainder beneficiaries. The Massachusetts Supreme Judicial Court had held that the taxable transfer occurred when the remainder beneficiaries became entitled to receive the trust property on their father's death in 1925. *Id.* at 595.

The United States Supreme Court reversed, holding that the remainder interest in the trust came "into effect in possession or enjoyment" when the trust was irrevocably formed in 1907, not when Mr. Coolidge died in 1925[10]. *Id.* at 597.

> Upon the happening of the event specified without more, the trustees were bound to hand over the property to the beneficiaries. Neither the death of Mrs. Coolidge nor her husband was a generating source of any right in the remaindermen. Nothing moved from her or him or from the estates of either when she or he died. There was no transmission then. The rights of the remaindermen, including possession and enjoyment upon termination of the trusts, were derived solely from the deeds.

Id. at 597-98 (citation omitted). The Court further concluded that "[n]o act of Congress has been held by this court to impose a tax upon possession and enjoyment, the right to which had fully vested prior to the enactment." *Id.* at 599. Because the transfer was completed prior to the enactment of the law, the Court held that the transfer was outside the reach of the tax. *Id.*

[10] The Court also reversed on constitutional grounds, discussed below in Section IV(F).

3. The Only Other State Court to Have Examined Whether a Marital Trust is "Transferred" by the Surviving Spouse has Ruled that There is No Transfer of Property on the Death of the Surviving Spouse.

The only other state court to address a similar issue has held that a marital trust created by a predeceasing spouse is not subject to an inheritance tax on the death of the surviving spouse. *See Indiana Dep't of State Revenue v. Estate of Morris*, 486 N.E.2d 1100 (Ind. 1986). In *Estate of Morris*, the Indiana appellate court examined whether the Indiana Department of Revenue could lawfully impose an inheritance tax on the surviving spouse's interest in a marital trust created by a predeceasing spouse's estate. *Morris*, at 1100. In *Morris*, the first dying spouse created a marital trust that created a life estate for her surviving spouse. Upon the surviving spouse's death, the Indiana DOR imposed a tax against the value of the marital trust, but the trial court ruled that because no transfer had occurred from the surviving spouse's estate, no tax could be imposed. *Id.*

The appellate court stated that "the decisive question then is whether the decedent had an interest in the property which is passed to the beneficiary upon his death." *Id.* at 1101. The Indiana court reviewed the rule set down by the Indiana supreme court previously in *Matter of Estate of Bannon*, 171 Ind. App. 610, 358 N.E.2d 215 (1976). In *Bannon*, the court established a 2-prong test for the imposition of estate tax. To impose

a tax, there must be: (1) a transfer from a decedent; (2) of an interest in property which the decedent owned at death. *Id.* No transfer occurred because the trust corpus merely flowed through the surviving spouse's estate under the first spouse's control. *Morris,* at 1102. The statute does not impose a tax unless there is some disposition on the part of the deceased. *Id.* Here, the trust simply passed under the will of the decedent. *Id.*

Neither Barbara nor her estate transferred property from William's Trusts, which is required by RCW 83.100.040(1) as a precondition to the imposition of estate tax in this case. Moreover, *McGrath* and *Coolidge* are binding upon this court and the DOR: the state cannot impose an estate tax on property the decedent did not own and therefore could not transfer. Applying the consistent rule in *McGrath, Coolidge*, and *Morris*, the DOR cannot impose a new estate tax against Barbara's Estate for William's Trusts' property because she did not own, control or transfer any property in these trusts. That transfer occurred at William's death.

D. The New Act Cannot be Applied to William's Transfers to the Marital Trusts Because the Legislature Mandated that the New Act Not Apply Retroactively.

1. The New Act Imposes a New Stand Alone Tax.

The Act is not simply an amendment to the prior tax law; it imposes a new tax. The Act was in direct response to the Washington

Supreme Court's rejection of the DOR's approach in *Hemphill* that "until or unless the legislature revises RCW 83.100.030 to specifically and expressly create a *stand alone* estate or inheritance tax," the state's estate tax would remain a pickup tax. *Id.* at 551-52 (emphasis added). In direct response to the *Hemphill* decision, Washington's legislature passed the Act.

The DOR concedes that the stand-alone estate tax that was adopted on May 17, 2005 is a *new* tax scheme. In explaining the purpose for its own proposing rules in December 2005, the DOR wrote:

> "[n]ew estate tax rules are needed to implement *the new Washington estate tax* that became effective May 17, 2005. . . . *The new rules clarify the nature of the new tax*, property subject to the tax, the Washington qualified terminable interest property election, the new method of estate tax apportionment, filing dates, refunds, the new farm deduction, and escheat estates and absentee distributee property."

CP 878 (ital. added); *compare also* WAC 458-57-005 (rules describing the nature of Washington state's estate tax as it is imposed by chapter 83.100 RCW for deaths occurring on or before May 16, 2005) *with* WAC 458-57-105 and 115 (rules that apply to deaths occurring on or after May 17, 2005).

2. The New Act is Applied Prospectively Only to Estates of Decedents Dying on or After May 17, 2005.

According to the legislature's stated intent, the new tax "applies prospectively only and not retroactively" to estates of decedents dying on or after May 17, 2005. Laws of 2005, Ch. 516, § 20. Thus, by the legislature's own mandate, the new Act cannot be applied to the September 14, 2004 transfers made by the William's Estate, before the effective date of the Act. CP 12. Even if the legislature had not been clear about prospective application, Washington courts hold that retroactive application of statutes is disfavored. *Am Discount Corp. v. Shepherd*, 160 Wn.2d 93, 99, 156 P.3d 858 (2007). This retroactive application is the foundation of the DOR's position in this case. By excluding the amount of William's Trusts from Barbara Nelson's taxable estate (as the 2006 Regulations also required), the tax is applied prospectively only.

3. Retroactive Application of the New Act Would Effectively Circumvent The Supreme Court's Decision in *Hemphill* by Imposing a Tax on William's Trusts

The effect of the *Hemphill* ruling was to phase out Washington's pickup tax during a four-year period from 2001 to the end of 2004, because the federal death tax credit was phased out. *Hemphill,* 153 Wn.2d at 548-49. From January 1, 2005 on (through May 16, 2005), Washington had no estate tax. *Id.* William C. Nelson was subject to an estate tax that

was 75% less than the DOR attempted to impose on estates in 2004. Absent the new statute, Barbara's Estate would have paid no Washington state estate tax under the former pickup tax scheme as a result of the *Hemphill* decision, because the federal death tax credit was non-existent as of the date of her death on April 9, 2006. By imposing this tax retroactively, the DOR is effectively circumventing this Court's ruling under *Hemphill* to grab a tax under the new Act it could not otherwise have imposed under the pickup tax regime.

E. The Department's Position Must be Rejected Because it is Inconsistent with the Purpose of the New Tax Scheme.

Although the new Act imposes and collects a tax only with respect to "transfers"[11] of the decedent's property, the DOR argues that because the heading in the table for calculating the tax in RCW 83.100.040(2) refers to "Washington taxable estate," and "Washington taxable estate" is equivalent to "federal taxable estate" under the definitions in RCW 83.100.020(13) & (14), Barbara's Estate can be taxed for William's Trusts because they are pulled back into the federal taxable estate under the special rule described in I.R.C. § 2044. This conclusion is wrong for a multitude of reasons.

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[11] *See* footnote 7.

First, the textual structure of RCW 83.100.020 operates to exclude any I.R.C. § 2044 property from Washington state estate tax. The first paragraph of RCW 83.100.020 (Subsection [1]) is the operative taxing authority of the statute. RCW 83.100.020(1) provides that a tax is imposed "on transfers of property" of the decedent. If property is not transferred under Subsection (1), then the second paragraph, 83.100.020(2), does not apply. To illustrate this application of the operation of the statute, assume that the federal taxable estate included *only one asset*—I.R.C. § 2044 property in which the decedent's surviving spouse has no legal interest at his or her death. The asset would be included on the federal tax return solely by virtue of the operation of Section 2044 under federal tax law. However, under the new Act, because the surviving spouse does not own, control or transfer the property, the Subsection (1) of 83.100.020 is not met, so Subsection (2) does not come into play at all – there is no estate property of the decedent on which to impose or collect an estate or transfer tax.

Second, the third paragraph of RCW 83.100.040 contains interpretive rules for applying the tax in the new Act that solve the seeming contradiction between the taxing authority of RCW 83.100.040(1) and the definitions in RCW 83.100.020(13) & (14) argued by the DOR. The tax imposed by the new Act "incorporates **only**

those provisions of the Internal Revenue Code . . . that do not conflict with the provisions of this chapter." RCW 83.100.040(3). Incorporating I.R.C. § 2044 conflicts with the notion of applying the new Act only to prospective transfers of decedents dying after May 17, 2005. Therefore, it should not be applied in computing the Washington taxable estate. The language of RCW 83.100.040 can be easily reconciled by excluding I.R.C. § 2044 (QTIP) Property from its application[12].

Third, the Washington Supreme Court has on two prior occasions ruled that the purpose of a tax statute prevails over the technical definitions contained in the statute, particularly in cases where the DOR's slavish application of definitional language leads to conclusions that are contrary to the purpose of the statute. *See Hemphill*, 153 Wn.2d 544, 105 P.2d 391 (2005); *Estate of Turner v. Dep't of Revenue*, 106 Wn.2d 649, 724 P.2d 1013 (1986). In *Hemphill*, the DOR argued a literal interpretation of Washington's former "pickup tax" statute. The DOR contended that a change in the statute in 2001 defined "federal credit" based upon "the United States Internal Revenue Code of 1986, as amended or renumbered as of January 1, 2001." *See Hemphill*, at 549

[12] This conflict only appears in those cases in which one spouse dies before May 17, 2005 and the second spouse dies after the enactment of the new Act. When both spouses die on or after May 17, 2005, RCW 83.100.047 authorizes elections for Washington QTIPs to defer tax. However, prior to May 17, 2005, no QTIP election could have been made, thus no Washington tax could be deferred.

(citing definitions in former RCW 83.100.020(3),(15)). The taxpayers contended that the operative meaning of RCW 83.100.030 asserted a legislative intent that does not exceed current federal credits, notwithstanding the statute's definitional language. *Id.* The Supreme Court agreed, and held that despite the literal language of the statute as amended in 2001, the statutory scheme was that the estate tax be matched to the current federal tax credit. *Id.* at 550-51. Similarly, in *Estate of Turner*, the DOR argued that the literal definition of "federal credit" was "the credit for estate taxes allowed by Section 2011," and did not include credits in Sections 2010 & 2013 of the I.R.C. *See Estate of Turner*, at 655. The Court similarly ruled against the DOR, holding that the purpose of the pickup tax statute was to match the federal credits to the state tax. *Id.*

The purpose of the tax changed dramatically on May 17, 2005. Now, rather than a "pickup tax" that is matched perfectly with the federal state death tax credit, the new Act imposes a stand-alone tax on "transfers of property" that does not depend upon the federal tax, and expressly excludes any inconsistent federal tax sections. In order to fulfill the objective of the new tax on transfers of the decedent's property, I.R.C. § 2044 property must be excluded.

Fourth, to the extent the DOR's position creates any ambiguity in the new Act, the *Hemphill* court made it clear: "ambiguities in taxing

statutes are to be construed 'most strongly against the government and in favor of the taxpayer.'" *See Hemphill*, at 552, citing *Department of Revenue v. Hoppe*, 82 Wn.2d 549, 512 P.2d 1094 (1973). The DOR's argument is that notwithstanding the expressed purpose of taxing only transfers of the decedent's property (consistent with the longstanding purpose of estate tax laws), the stand-alone nature of the tax, and the prospective application of the tax, the marital trusts are subject to tax. Even though the DOR argues a different interpretation, the statute should be construed "most strongly" in favor of the taxpayers. *Id.*

Fifth, a new tax burden can be created only by law that clearly states such a purpose. *See Hemphill*, at 551. The *Hemphill* court supported its opinion by citing Washington Constitution Art. VII, § 5, which provides:

> No tax shall be levied except in pursuance of law; and every law imposing a tax shall state distinctly the object of the same to which only it shall be applied.

The purpose of the new Act was to create a "stand-alone tax" imposed on "transfers of property" of the decedent, independent of any federal tax obligation. Any other purpose cannot be upheld under the Washington Constitution. Because there is no clear provision in the new Act to tax

marital trusts created by a predeceasing spouse's estate, the DOR's interpretation would also violated the Washington Constitution.

F. Nothing in Federal Tax Law Warrants a Conclusion that the Decedent Transferred the Marital Trust Property.

As noted above, William's Trusts are marital trusts under state law and, at the same time, QTIP trusts under federal law. Nothing in the Internal Revenue Code suggests that a "transfer" of assets in a QTIP trust occurs upon the death of the surviving spouse. Courts have confirmed that property in a federal QTIP trust is not owned by the surviving spouse and "does not actually pass to or from" the surviving spouse. *See Estate of Bonner v. U.S.*, 84 F.3d 196, 198 (5th Cir. 1996); *Estate of Mellinger v. Comm'r*, 112 T.C. 26 (1999). Analyzing I.R.C. § 2044(c) the court in *Mellinger*, 112 T.C. 26, 35-36 (1999) held:

> This [QTIP] property is "treated as property passing from the" surviving spouse, § 2044(c), and is taxed as part of the surviving spouse's estate at death, *but QTIP property does not actually pass to or from the surviving spouse*. . . . .
>
> Neither § 2044(c) nor the legislative history indicates that the decedent should be treated as the owner of QTIP property for this purpose. (emphasis added).

Indeed, I.R.C. § 2044(c) specifically provides that "[f]or purposes of this chapter and chapter 13, property includible in the gross estate of the

decedent under subsection (a) shall be *treated* as property passing from the decedent." I.R.C. § 2044(c) (emphasis added).

Barbara Nelson did not own the property in William's Trusts, nor did she control the disposition of that property at the time of her death. *See Estate of Bonner v. United States*, 84 F.3d 196 (5th Cir. 1996); *Estate of Mellinger v. Comm'r*, 112 T.C. 26 (1999). All Barbara Nelson had was the right to receive specified benefits from the trust during her lifetime. The assets of QTIP trusts are in fact controlled at every step by the first spouse to die. *Bonner,* 84 F.3d at 198. "The estate of each decedent should be required to pay taxes on those assets whose disposition that decedent directs and controls, in spite of the labyrinth of federal tax fictions[13]." *Id.* at 199.

The taxable "transfer" occurred when the rights of the remainder beneficiaries of William's Trusts were vested at the time of William's death. Barbara Nelson did not transfer that property. On her death, the trust property passed automatically to the remainder beneficiaries of the trust, the terms of which were created and determined by her predeceased

[13] Section 2044 is a fiction under federal tax law. As stated in *Clayton v. Comm'r of the I.R.S.*, "Out of thin air and from whole cloth, Congress invented a brand new, theretofore unseen concept: Qualified Terminable Interest Property." If 'unlimiting' the Marital Deduction was a flight into the wild blue yonder, Congress truly 'slipped the surly bonds of earth' with the advent of QTIP." 976 F.2d 1486, 1493 (5th Cir. 1992).

spouse, William Nelson, who died before May 17, 2005. *Coolidge v. Long*, 282 U.S. 582, 597, 51 S. Ct. 306, 75 L. Ed. 562 (1931).

Absent a statute that makes the surviving spouse the transferor of the trust assets under either Washington property law or Washington state estate tax purposes, William's Trusts assets cannot be taxed as part of Barbara's Washington taxable estate. *See Helvering v. Safe Deposit & Trust Co. of Baltimore*, 316 U.S. 56, 62 S. Ct. 925, 86 L. Ed. 1266 (1942).

G. The DOR's Interpretation of the New State Estate Tax Would Render the Act Unconstitutional.

Application of the Washington estate tax to property (1) held in an irrevocable marital trust created prior to May 17, 2005, and (2) that was never previously subject to the stand-alone Washington estate tax is not only contrary to the Legislature's express intent, but would also constitute a retroactive application of the tax in violation of both the Impairment clauses[14] and Due Process clauses[15] of the United States and Washington State constitutions.

A retroactive statute is unconstitutional when it takes away or impairs vested rights acquired under existing laws. *In re Martin*, 129 Wn.

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[14] Article I, Section 10 of the U.S. Constitution provides that "[n]o state shall . . . pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts." Article I, section 23 of the Washington Constitution provides that "[n]o bill of attainder, ex post facto law, or law impairing the obligations of contracts shall ever be passed."

[15] The 14th Amendment to the United States Constitution and Article I, Section 3 of the Washington State Constitution provide in essential part that "[n]o person shall be deprived of life, liberty or property without due process of law."

App. 135, 145, 118 P.3d 387 (2005) (*quoting I.N.S. v. St. Cyr*, 533 U.S. 289, 321, 121 S. Ct. 2271, 150 L. Ed. 347 (2001)); *Wash. Farm Bureau Fed. v. Gregoire*, 162 Wn.2d 284, 304-05, 174 P.3d 1142 (2007) (holding that the legislature may not give an amendment retroactive effect where the effect would be to interfere with vested rights). Vested rights are entitled to due process protections from subsequently enacted legislation. *Gregoire*, 162 Wn.2d at 305. A vested right entitled to protection from legislation must be something more than a mere expectation based upon an anticipated continuance of the existing law; it must have become a title, legal or equitable to the present or future enjoyment of property. *Id.* (*quoting Lawson v. State*, 107 Wn.2d 444, 455, 730 P.2d 1038 (1986)).

The Legislature may not interfere with or divest estates which have already become vested through the death of the testator. *Strand v. Stewart*, 51 Wash. 685, 687-88, 99 P. 1027 (1909). An interest in an estate vests immediately upon the death of the ancestor in the heir or devisee entitled thereto, subject only to the rights of creditors. *In re Verchot's Estate*, 4 Wn.2d 574, 582, 104 P.2d 490 (1940); *see also Estate Burns v. Olver*, 131 Wn.2d 104, 118 n.4, 928 P.2d 1094 (1997) (recognizing that heirs' rights vest upon testator's death). The rights of the remainder beneficiaries of William's Trusts vested at the time of William's death, before Barbara Nelson died.

1. Retroactive Taxation Violates the Impairment Clauses.

Applying the new Act to William Nelson's irrevocable federal QTIP trust violates the Impairment clauses of both the United States and Washington State constitutions. The Impairment Clause treats a trust like any other contract in its application. In *Coolidge*, 282 U.S. 582, 605, the United States Supreme Court stated that:

> We conclude that the succession was complete when the trust deeds of Mr. and Mrs. Coolidge took effect, and the enforcement of the statute imposing the excise tax in question would be repugnant to the contract clause of the Constitution and the due process clause of the Fourteenth Amendment.

The Washington Supreme Court has followed *Coolidge* in holding that the state's imposition and collection of tax for transfers predating the tax violates both the state and federal constitutions:

> An act, subsequently passed, authorizing the taking from those sums of an exaction in the guise of an inheritance tax, would impair the obligation of those contracts, within the meaning of section 10, article 1 of the Federal Constitution: "No State shall . . . pass any . . . Law impairing the Obligation of Contacts" and it would at the same time conflict with section 23, article 1 of our own Constitution, which is as follows: "No . . . law impairing the obligations of contracts shall ever be passed."

In re McGrath's Estate, 191 Wash. 496, 71 P.2d 395 (1937). In formulating its holding the *McGrath* Court noted that in *Coolidge* the remainder beneficiaries' rights to take the trust property upon their parents' deaths arose and vested in them when the Coolidges created the trust. *Id.* at 508. By analogy the *McGrath* Court found that McGrath Candy Company's right to take the proceeds of the life insurance arose and vested in the company when it executed the insurance contracts. *Id.* Any subsequent statute that attempted to tax the insurance proceeds would, if enforced, impair the company's contractual rights because the company would receive less than it was entitled to receive under the terms of the contact. *Id.* at 508-09; s*ee also Blodgett v. Holden*, 275 U.S. 142, 147, 48 S. Ct. 105, 72 L. Ed. 206 (1927) (assessing a tax upon gifts completed before effective date of gift tax was unconstitutional and wholly unreasonable).

The DOR's imposition of the Washington estate tax on William Nelson's irrevocable federal QTIP trusts is an unconstitutional impairment of the rights arising from those trusts. The trusts arose, and the property subject to the trusts vested in the remainder beneficiaries, prior to the enactment of the new stand-alone Washington estate tax. From the date the trusts were created they were irrevocable contracts within the meaning of the state and federal constitutions. To apply the later-enacted

Washington estate tax to these trusts would impair the rights of the trusts' beneficiaries in contravention of the Impairment Clauses of the federal and state constitutions.

2. Retroactive Taxation Violates the Due Process Clauses.

Not only does the imposition of the Washington estate tax to William Nelson's federal QTIP trust violate the Impairment Clauses, it violates the Due Process Clauses of the United States and Washington State constitutions. In *Coolidge*, the Supreme Court held that the retroactive application of a taxing statute violates the Due Process Clause because the remainder beneficiaries are deprived of their property without due process of law. 282 U.S. at 605. Likewise, under Washington law, "[a] retroactive law violates due process when it deprives an individual of a vested right." *State v. Varga*, 151 Wn.2d 179, 195, 86 P.3d 139 (2004) (internal quotation marks and citation omitted). Retroactive laws allow the legislature "to sweep away settled expectations suddenly and without individualized consideration." *Landgraf v. USI Film Products*, 511 U.S. 244, 266, 114 S. Ct. 1483, 128 L. Ed. 2d 229 (1994). Applying the new Washington estate tax to William Nelson's federal QTIP trust, which was irrevocable before the enactment of the Act, deprives the trust

beneficiaries of their property rights without due process, which is prohibited by both the federal and state constitutions.

The United States Supreme Court declines "to give retroactive effect to statutes burdening private rights unless Congress had made clear its intent." *Id.* at 270. Where a statute "expressly prescribe[s] the statute's proper reach," however, "there is no need to resort to judicial default rules." *Id.* at 280. In a recent case dealing with a state B&O tax exemption, a majority of this Court found persuasive the argument that a state cannot impose tax on someone based upon the actions of another person whose actions are beyond the taxpayer's control. *Dot Foods Inc. v. Dept. of Revenue*, 166 Wn.2d 912, 923, 215 P.3d 185 (2009). The Court agreed that such a holding is required by the Due Process Clauses of both the United States and Washington state constitutions. *Id.* Here the DOR seeks to tax Barbara Nelson's Estate based on the transfer of property by William Nelson's estate, which was beyond Barbara Nelson's control.

The DOR's application of the Washington estate tax to William's Trust property would violate both federal and state constitutions.

H. The DOR's Own Clear Regulations Provide an Alternate Basis for Granting Judgment in Favor of Barbara's Estate.

1. The 2006 Regulations are Clear on Their Face and Apply to All Estates of Decedents Dying After May 17, 2005.

The Washington Legislature gave specific direction to the DOR to adopt regulations necessary to carry out the provisions of the new stand-alone estate tax act. RCW 83.100.200. Under the 2006 Regulations promulgated by the DOR (and under which Barbara's Estate filed its Washington estate tax return), the Washington taxable estate is determined by making adjustments to the federal taxable estate. WAC 458-57-105(3)(q) (2006); WAC 458-57-115(2)(d) (2006). One of the required adjustments was that any amount included in the federal taxable estate pursuant to I.R.C. § 2044 (inclusion of amounts for which a federal QTIP election was previously made) is to be removed in computing the Washington taxable estate. WAC 458-57-105(3)(q)(vi) (2006); WAC 458-57-115(2)(d)(vi) (2006).

2. The Plain Meaning Rule Applies to the 2006 Regulations.

The rules of statutory interpretation apply to agency regulations. *Tesoro Refining & Marketing Co. v. Dept. of Revenue*, 164 Wn.2d 310, 322, 190 P.3d 28 (2008); *Mader v. Health Care Authority*, 149 Wn.2d 458, 472, 70 P.3d 931 (2003); *Multicare Medical Center v. DOR of Social*

& Health Services, 114 Wn.2d 572, 591, 790 P.2d 124 (1990). "If an administrative rule or regulation is clear on its face, its meaning is to be derived from the plain language of the provision alone." *Cannon v. DOR of Licensing*, 147 Wn.2d 41, 56, 50 P.3d 627 (2002); *Lacey Nursing Center, Inc. v. DOR*, 128 Wn.2d 40, 53, 905 P.2d 338 (1995) (review of regulation begins with plain language); *Waste Management v. WUTC*, 123 Wn.2d 621, 629 869 P.2d 1034 (1994) (where regulation is unambiguous, court determines legislative intent from regulatory language alone).

The language of an unambiguous regulation is given its plain and ordinary meaning unless the legislative intent indicates to the contrary. *Tesoro*, 164 Wn.2d at 322; *Stevens v. Brink's Home Security, Inc.*, 162 Wn.2d 42, 47, 169 P.3d 473 (2007). Where a rule is unambiguous, the Court does not speculate as to its intent, nor question the wisdom of a particular regulation, it merely determines what the regulation requires. *Mulitcare*, 114 Wn.2d at 591. "Regulations are interpreted as a whole, giving effect to all the language and harmonizing all provisions." *Cannon*, 147 Wn.2d at 50. The Court must assess the plain meaning of a statute or regulation by viewing the words of the particular provisions in context, together with related statutory provisions and the statutory scheme as a whole. *Tesoro*, 164 Wn.2d at 319; *Burns v. City of Seattle*, 161 Wn.2d 129, 140, 164 P.3d 475 (2007); *Washington Public Ports Association v.*

Dept. of Revenue, 148 Wn.2d 637, 645, 62 P.3d 462 (2003). The Court also must consider the subject, nature and purpose of the statute or regulation as well as the consequences of adopting one interpretation over another. *Tesoro*, 164 Wn.2d at 319.

Under the plain reading of the 2006 Regulations, property that is included in the decedent's federal taxable estate under I.R.C. § 2044 is excluded in determining the decedent's Washington taxable estate. WAC 458-57-105(3)(q)(vi) (2006); WAC 458-57-115(3)(d)(vi) (2006). The trial court's ruling and the DOR's interpretation are contrary to the plain language of the regulations.

3. The Court Should Not Defer to the DOR's Interpretation.

The DOR will contend that its interpretation of the 2006 Regulations should apply. However, this Court has directed that trial courts should not defer to an agency's interpretation of legislative intent or its own regulations unless the statute or regulations are ambiguous in the first place. *Dot Foods, Inc. v. Dept. of Revenue*, 166 Wn.2d at 921; *Waste Management of Seattle, Inc. v. Utilities & Transportation Commission*, 123 Wn.2d 621, 627-28, 869 P.2d 1034 (1994). This Court also has instructed that trial courts should not defer to an agency's interpretation of regulations that are not plausible or that are contrary to the legislative

intent. *Bostain v. Food Express Inc.*, 159 Wn.2d 700, 153 P.3d 846 (2009) (no deference due agency interpretation regardless of whether it is stated in an agency rule when agency interpretation conflicts with statute); *Cobra Roofing Services, Inc. v. Dept. of Labor & Industries,* 122 Wn. App. 402, 409, 97 P.3d 17 (2004); *Flanigan v. DOR of Labor & Industries*, 123 Wn.2d 418, 426, 869 P.2d 14 (1994) (statutory interpretation must not reach an absurd result). The Court will uphold an agency's interpretation of a regulation only if "it reflects a plausible construction of the language of the statute and is not contrary to the legislative intent." *Seatoma Convalescent Center v. DOR of Social & Health Services*, 82 Wn. App. 495, 518, 919 P.2d 602 (1996). Moreover, the agency must apply and interpret its regulations consistent with the enabling statute. *Ortega v. Employment Security DOR*, 90 Wn. App. 617, 622, 953 P.2d 827 (1998).

Taxpayers have the right to rely on tax regulations adopted by the DOR. RCW 82.32A.020(2). Nowhere does WAC 458-57-105 or WAC 458-57-115 indicate that the 2006 Regulations do not apply to an estate in which the decedent's predeceased spouse died before May 17, 2005. Nothing in WAC 458-57-105 or WAC 458-57-115 indicates that the 2006 Regulations do not apply to estates with a federal QTIP trust but no Washington QTIP trust. Moreover, nothing in WAC 458-57-105 or

WAC 458-57-115 indicates how taxpayers would know which parts of the regulations to apply and which parts not to apply.

4. The 2009 Amendments Demonstrate that the 2006 Regulations Apply to Barbara's Estate.

The DOR's 2009 Amendments to WAC 458-57-105(3)(q)(vi) and WAC 458-57-115(2)(d)(vi) suggest that the 2006 Regulations apply to estates like Barbara's Estate. The DOR amended those sections to add the underlined clause: "(vi) Less any amount included in the federal taxable estate pursuant to IRC § 2044 (inclusion of amount for which a federal QTIP election was previously made), from a predeceased spouse that died on or after May 17, 2005." WAC 458-57-105(3)(q)(vi) and WAC 458-57-115(2)(d)(vi) (effective Feb. 22, 2009). Although the 2009 Amendments completely change the law regarding the inclusion of QTIP property, the DOR claimed the amendment was simply a "clarification." *See* CP 601. If the DOR needed to "clarify" the regulations specifically for estates in which the first spouse died before enactment of the Act, then the 2006 Regulations must have applied to estates like Barbara's Estate.

5. Summary.

When properly applied, the 2006 Regulations lead to the inevitable conclusion that I.R.C. § 2044 property is to be excluded in the calculation of the Washington taxable estate. WAC 458-57-105(3)(q)(vi) (2006); WAC 458-57-115(2)(d)(vi) (2006). Barbara's Estate followed the

direction of the 2006 Regulations and properly excluded the remaining property in William Nelson's irrevocable federal QTIP trusts from her Washington taxable estate. The Court should reverse the trial court's rulings.

V. CONCLUSION

Under RCW 83.100.040, the DOR has no authority to impose a tax on transfers of property in estates of decedents dying before May 17, 2005. The legislature provided that the Act would apply prospectively to estates of decedents dying on or after May 17, 2005. Under the language of the new Act, the uniform rule of law in Washington, the U.S. Supreme Court and the only other state to address a similar issue, Barbara's Estate cannot be required to pay an estate tax on William's Trusts because she did not own or transfer property in the trusts. The DOR's interpretation of the new Act would also lead to an unconstitutional retroactive tax.

The 2006 Regulations also apply to all estates of decedents dying after May 17, 2005, including Barbara's Estate, and plainly required Barbara's Estate to exclude § 2044 property, including William's QTIP trusts, from Barbara's Washington taxable estate. The 2006 Regulations are consistent with the new Act, which applies to transfers by decedents and is to be applied prospectively only.

Barbara Nelson's Estate respectfully requests that this Court reverse the trial court's order granting summary judgment in favor of the DOR and denying summary judgment in favor of Barbara Nelson's Estate. The Estate also requests that this Court enter judgment in favor of Barbara Nelson's Estate that no additional estate tax is due and owing.

Respectfully submitted this 8th day of June 2010.

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PROOF OF SERVICE

I, Lynn Riggs, the undersigned, hereby certify and declare under penalty of perjury under the laws of the State of Washington that the following statements are true and correct:

On this date, I caused to be served a true copy of the document entitled BRIEF OF APPELLANTS to which this is attached, by First Class U.S. Mail and electronic mail on the following:

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Lynn Riggs